

# City of Newport Beach

## Revenue Forecast



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This publication was prepared for:

## City of Newport Beach

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## REPORT OVERVIEW

**Beacon Economics, LLC** has undertaken a forecast of key revenue streams for the City of Newport Beach extending to the 2021–22 fiscal year. The forecast presented here uses standard time-series econometric techniques based on historical correlations and forecasts of future economic trends. **Beacon Economics'** method of forecasting follows a layered approach: National policy changes and external shocks are built into a U.S. model with a variety of economic indicators, including GDP, production, demographics, interest rates, government spending, taxes, savings, income growth, and real estate. **Beacon Economics** then crafts a California model that incorporates macro trends at the national level as well as trends in the statewide economy, including employment/labor markets, demographics, real estate, and business activity indicators.

Taking into account these state and national factors, **Beacon Economics** sets up a regional model for the City of Newport Beach using macro trends to create a local forecast that delivers a broad outlook for the region, including:

- Employment by industry
- Unemployment rate
- Consumer spending and income trends
- Population and components of change
- Residential and nonresidential real estate and construction.

The regional assessment highlights the major drivers at the national level, continues with developments in the State of California, and zooms in on the economy of the County of Orange and the City of Newport Beach to provide a forecast of key revenue streams for the City extending to fiscal year 2021–22.

### *City of Newport Beach Revenue Forecast*

Revenue Stream	Actual	Forecast					
	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
Assessed Value (\$ 000s)	47,388,470	50,468,451	53,402,087	56,511,054	59,825,780	63,160,970	66,619,170
Growth(%)	5.9	6.5	5.8	5.8	5.9	5.6	5.5
Property Tax	73,256,147	77,742,906	82,261,955	87,051,087	92,157,177	97,294,790	102,621,891
Growth(%)	7.4	6.1	5.8	5.8	5.9	5.6	5.5
Taxable Sales (\$ 000s)	3,006,685	3,180,060	3,349,519	3,521,518	3,696,152	3,867,221	4,040,445
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Growth(%)	2.0	8.8	7.0	6.6	6.5	6.5	6.3
Building Permit Valuations	270,616,499	340,045,500	354,792,900	366,309,700	378,918,700	390,610,400	401,422,600
Growth(%)	-48.9	25.7	4.3	3.2	3.4	3.1	2.8

Source: Forecast by Beacon Economics

## NATIONAL AND STATE ECONOMIES

The future direction of the City's economy is heavily dependent on what happens with the national and state economies. In the most recent edition of *Beaconomics* (free of charge at [www.BeaconEcon.com](http://www.BeaconEcon.com)), **Beacon Economics** provides an in-depth analysis of current national and state economic trends. Below is a brief summary of what **Beacon Economics** sees happening in the U.S. and California economies.

### United States Economy

- Prior to the election, all the major polls predicted a Hillary Clinton victory. We, like many economists, took these polls at face value—and our forecast reflected (for better or worse) the continuation of the policies in place under the Obama administration. The election of Donald Trump to the presidency clearly changes our outlook for the U.S. economy, albeit how it will change is still unknown. This will depend greatly on the first few months of the Trump presidency as he begins to identify his policy priorities. There are potential upsides to his administration, albeit nowhere near in proportion to the campaign rhetoric. There are also many potential downsides, to the point that there is now a very real probability of a recession over the next two to three years.
- Putting the election to one side, the U.S. economy, thus far, has continued to chug along. The gross domestic product (GDP) had been growing at a below average pace, but in Q3 the rate of growth picked up as GDP increased at a 3.2% annual rate from the prior quarter.
- New economic data will be watched with heightened scrutiny with each release, but for the time being virtually all the indicators are trending in the right direction. Labor markets are at full employment, wages are starting to rise, and asset prices are at or near record levels.
- Consumer spending, despite a slower third quarter, remains one of the bright spots and sources of momentum in the U.S. economy. When properly and thoroughly accounting for sources of income, the data show that Americans have seen solid gains in standard of living over the last two decades.
- There has been modest slowing in job growth, but that is not because of a lack of demand for workers –the U.S. Bureau of Labor Statistics has estimated that the job openings rate remains at an all-time high level. Rather, the tight labor market is making it difficult for employers to find the right employees.

### California Economy

- California stayed the course with a solid economic performance through the first three quarters of 2016 despite slower growth nationally. The state outdistanced the nation in terms of economic growth and job creation, although the pace of growth in both California and the United States has been somewhat slower than last year.
- Virtually every industry continues to add jobs in yearly terms. Health Care and Social Assistance have led the way with the absolute largest job gains; significant contributions have also come from Leisure and Hospitality, Professional, Scientific, and Technical Services, and Construction, illustrating the breadth of job gains throughout the private sector of the economy.
- In addition to steady job gains, spending activity statewide, as measured by taxable sales, has been growing steadily over the last few years. Following an increase of more than 4% last year, taxable sales were up by more than 2% through the first three quarters of 2016, with data from the busy holiday season still ahead.

- The picture for housing has been mixed since the recession, with prices advancing modestly despite many hurdles that have limited sales activity. Demand for housing has been sustained by continued low interest rates but has simultaneously been impeded by low inventories, high underwriting standards, and large down payment requirements.
- On the nonresidential side of real estate, market conditions reflect the improvement seen across the sectors and regions of the statewide economy. For both office and retail, vacancy rates have edged down quarter by quarter in metro areas of the State while lease rates have risen.
- Looking out towards 2017, the state's economic engine will chug along. Although growth may occur at a somewhat slower pace than in recent years, it should be noted that the U.S. economic expansion is approaching seven and a half years, making it one of the longest on record.

## CITY OF NEWPORT BEACH REVENUE FORECAST

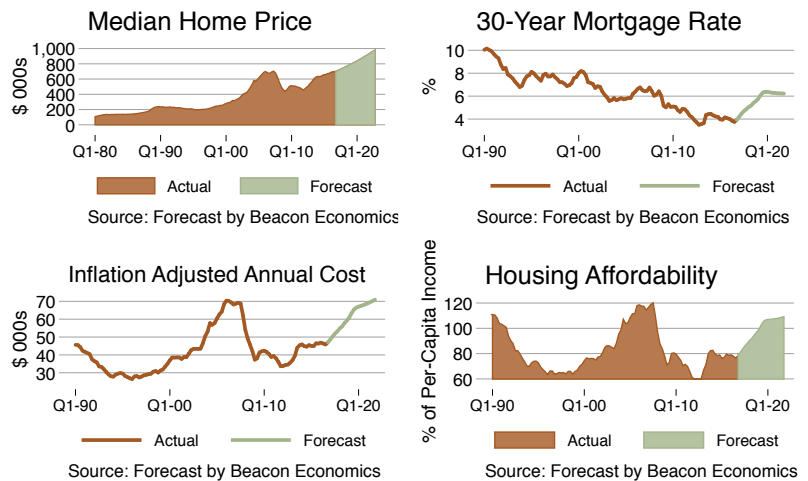
### Real Estate Driven Revenues

The local real estate market continued to make strong gains as price growth remained robust with a 2.4% year-over-year increase in the third quarter of 2016. The median price of an existing single-family home in the city was \$1,770,700 in the third quarter of 2016, representing a 2.2% gain on pre-recession peak values. Home sales activity is trending lower in year-to-date terms, with sales of existing single-family residences falling 7.7% through the first three quarters of 2016. Together, these trends have contributed to an overall 2.4% increase in city property tax revenues between the 2014-15 and 2015-16 fiscal years.

Low market inventories will also contribute to home price growth in the 2016-17 fiscal year as the tight supply continues to put upward pressure on prices. According to the California Association of Realtors, in November 2016 the existing supply of homes on the market in the County of Orange would have been exhausted in 3.3 months at the current pace of sales. This represents a decline from the 3.8-month average during the preceding 12 months. Inventories will probably tighten because of lower construction activity during the 2015-16 fiscal year, when the estimated value of all residential permits fell by 48% from the year prior. As low inventories trigger further price gains, sales volumes are expected to gain speed in the near term as homeowners are enticed by higher prices to sell and move up. Given that more than 80% of the City's assessed value (AV) is in residential homes, increases in home prices and sales can trigger higher growth in overall AV in the City compared to other region's where the AV share of residential homes is less.

### Orange County Home Price Outlook

*Price growth robust as mortgage rates at historic lows*



Meanwhile, the commercial side of real estate has been performing strongly as well. Although Reis, Inc., the leading provider of commercial real estate statistics, does not provide data at the city level, submarkets that include the City of Newport Beach are the hottest in the County of Orange. Rents in the retail submarket increased by 3.4% between the third quarter of 2015 and the third quarter of 2016. Even as 120,000 square feet of new retail stock came on line during that time, vacancy rates remained static at 5.6% because new stock was quickly absorbed. Although no new office stock was added to the submarket covering Newport Beach, asking rents in the submarket grew at a faster rate than in any other County submarket, with 5.0% year over year growth as vacancy rates dropped 0.5 percentage point to 15.5%.

Finally, California's Consumer Price Index (CPI) has been trending favorably from the standpoint of growth in the region's AV base. From October 2014 to October 2015, the California CPI grew by 1.5%, capping growth in properties not subject to reassessment at that level. Since then, however, year-over-year growth has trended higher than 2%, as the decline in energy prices recedes into the past and core inflation in the State remains firm. In fact, the latest data show that from October 2015 to October 2016, the California CPI grew by 2.6%, which will allow AV for properties not subject to reassessment to grow at the 2% upper end of Proposition 13 restrictions.

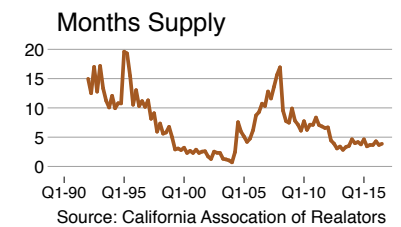
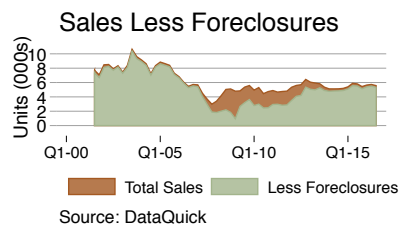
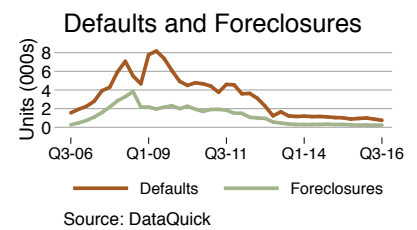
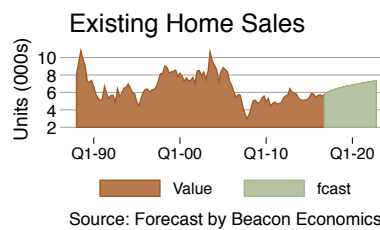
### **Business Activity Driven Revenues**

One clear sign of strength in the local economy is that job growth in the region has remained steady and has reached record high levels virtually every month. As of November 2016, nonfarm employment in the County stood at 1.6 million, a 2.4% increase over the same month a year earlier. Notably, in this category the County has continued to outpace the State, which saw 2.3% nonfarm job growth.

The Professional and Business Services industry, which employed 18.7% of Newport Beach's civilian workforce in 2015, has been the largest contributor to over-

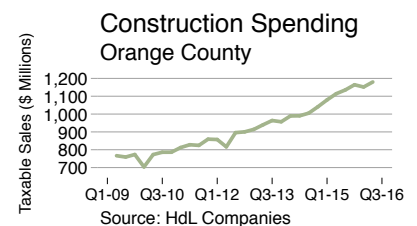
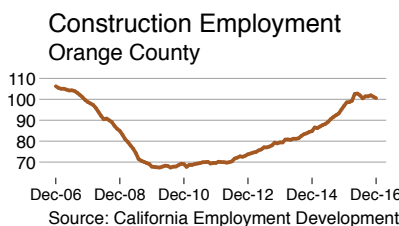
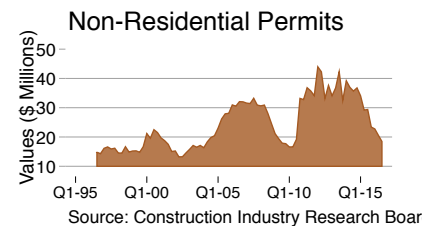
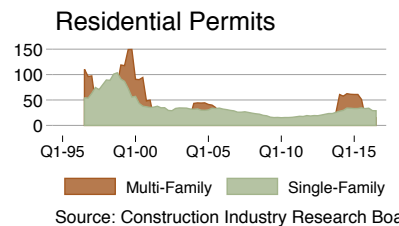
## **Orange County Home Sales Outlook**

*Low market supply continues to restrict sales volumes*



## **Newport Beach Construction Trends**

*Permitting Activity currently below Post-Recession Highs*





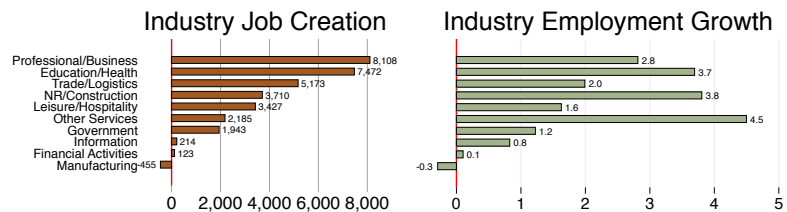
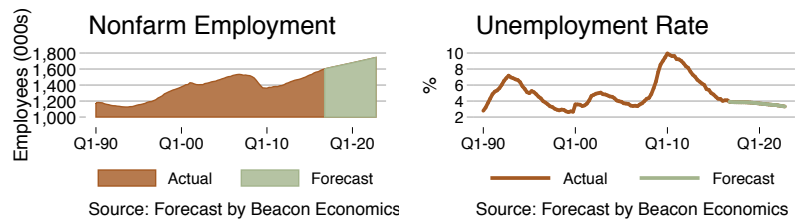
all job growth in the County over the last year. As of November 2016, this industry added 10,300 jobs, a 3.5% increase over the same period a year earlier, and represented 27.1% of the net increase across all nonfarm industries. The benefit of countywide gains in this sector was probably stronger in the City of Newport Beach, where the sector is the labor force's largest employer.

In the midst of slowing home sales, however, the Real Estate subsector posted the loss of 700 jobs. Although the Finance and Insurance subsector offset some of these losses with modest 0.5% employment gains, the Financial Activities sector as a whole contracted by 0.2%. Based on American Community Survey data, the Financial Activities industry employs a large component of the City labor force. Between 2014 and 2015, industry employment in the City contracted by 1.5%. However, this amounted to the loss of 120 jobs on a civilian employment base of 42,600. Despite some losses, the county economy is expected to exhibit positive growth over the next five fiscal years, as are consumer and business spending and subsequent revenues associated with spending by local residents, including sales tax and transient occupancy tax revenues.

As local residents have seen their incomes increase beyond what is necessary for basic expenditures, consumer spending on dining out and big-ticket items has been driving much of recent taxable sales growth. Metro level taxable receipt breakouts indicate that consumers are driving much of taxable sales growth in Orange County, based on data released by HdL Companies. In particular, the largest absolute increases in taxable spending were seen in the Restaurants and Hotels and Autos and Transportation categories in the first half of 2016.

## Orange County Labor Market

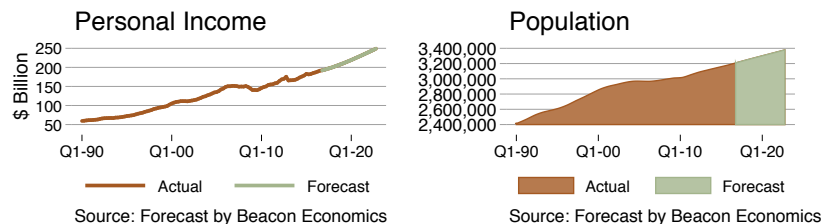
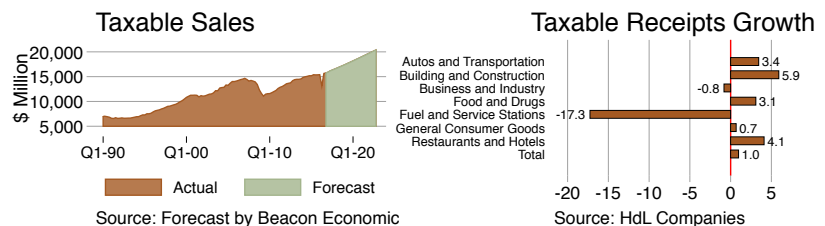
### New Record Employment Virtually Every Month



Source: California Employment Development Department

## Orange County Spending and Income

### Robust Labor Market Fuels Further Spending



### ***Demographics and Economic Statistics***

Population growth in the City of Newport Beach has been slow the last decade, growing by an average of 0.3% year over year since January 2006, based on California Department of Finance data. In contrast, population growth in the County grew by 0.7% over the same period. With median home prices far above the County median (\$1,770,700 compared to \$696,200), the high costs of living in the area may put downward pressure on population growth in the near term.

Although more residents are potentially being priced out of ownership, as demonstrated by renter rates that rose 1 percentage point to 45.1% between 2010 and 2015, multifamily development has been limited in recent years. On the whole, the distribution of housing stock in the city has remained heavily weighted toward single-family residences, which made up 61.5% of housing units in 2016.

As the county approaches full employment, tightening labor conditions are triggering wage increases. This has been amplified in Newport Beach, where the local unemployment rate stood at 4.2% in 2015, the latest data available from the American Community Survey (ACS), compared to 4.5% in the County in 2015.

Most City of Newport Beach residents are employed in three major industries: Financial Activities (includes finance and insurance as well as real estate and rental leasing and represented 16.4% of employed residents in the City), Professional and Business Services (20.0%), and Education and Health Care Services (17.7%). The share of total civilian employment in these industries has remained fairly constant since 2009, when the ACS began report these statistics for the City.

Retail and Leisure and Hospitality industries account for 8.1% and 8.6% of total civilian employment in the city, respectively. These industries should continue to have a notable presence in the local economy, given relative spending levels in the City. Per capita taxable sales in the City were \$35,700 in 2015 compared to \$19,400 in the County overall, indicating that residents and visitors alike are spending more money in the City than in the broader region, on average.

#### **Demographic and Economic Statistics, 2015**

Statistic	Newport Beach	Orange County
Population	87,131	3,169,776
Median Age	45.4	37.1
25 or older w/ High School Diploma or Less	10.5%	33.4%
25 or older w/ Post-Secondary Degree	64.6%	37.7%
Median Household Income	123,351	78,428
Per Capita Taxable Sales	\$35,700	\$19,400
Homeownership Rate	57.1%	56.7%
Single-Family Home % of Total	61.5%	62.2%
Median Existing Home Price	\$1,772,300	\$665,200
Unemployment Rate	4.2%	4.5%
% of Residentis Employed in:		
Natural Resources and Mining	0.2	0.6
Construction	3.4	6.0
Manufacturing	9.8	13.4
Wholesale Trade	5.2	3.5
Retail Trade	8.1	10.0
Trasnport, Warehouse, and Util.	3.3	3.4
Information	1.6	2.1
Financial Activities	16.4	8.5
Professional and Business	20.0	14.2
Education and Health	17.7	19.1
Leisure and Hospitality	8.6	11.1
Other Services	3.7	5.5
Government	2.2	2.7

**Source: American Community Survey**



Tourism indicators reinforce these trends as hotel rates in the City are greater than in the County overall and have exhibited more growth. As of October 2016, the average daily room rate in the City of Newport Beach was \$238.72, compared to the County average of \$181.59, and was 3.8% higher than the same month a year prior. The County's average room rates increased by 2.5% over the same period. Occupancy rates edged down over the period, but at 79.3% remained near historically high levels.

Steady improvement in the national, state and regional economies has been a boon to the local economy, which has been drawing in more spending from tourists. Through the first ten months of 2016, John Wayne Airport reported passenger traffic growth of 5%, year to date. Hotel revenues over the last year have been robust, as evidenced by a 2.0% increase in transient occupancy tax revenue from fiscal year 2014–15 to 2015–16. Employers have also responded to higher revenues by expanding payrolls, with 2.1% employment growth over the most recent annual period in the countywide Leisure and Hospitality sector.

The median household in the City makes almost 150% of the median household income in the County overall, in large part because of higher educational attainment rates. Compared to the County, differences in educational attainment are stark. In 2015, roughly 10.5% of the City population over 25 years old had only a high school diploma or less, compared to 33.4% in the County. Additionally, 64.6% of City residents have obtained a post-secondary degrees, compared to 37.7% in the County and 31.4% in the State. Between 2010 and 2015, educational attainment rates in the City were trending higher, with a 2.7 percentage point increase from 2010 levels.

This is a likely consequence of both high housing costs selecting for more skilled workers and increasing post-secondary enrollment rates in the local population under the age of 25. It follows that household incomes are trending upward and, based on American Community Survey estimates, the median household income grew by 4.7% year over year, reaching \$113,100 in 2015. By comparison, the rate of growth for countywide median household incomes was just 0.7% in that time frame.

## SUMMARY

**Beacon Economics'** current forecast represents an optimistic outlook through the 2021–22 fiscal year and assumes that the U.S. economy will continue to grow at a moderate pace, much as it has in recent years. Because of the lack of certainty regarding President Trump's policies, there is an inherent uncertainty within this forecast. **Beacon Economics** will be closely monitoring policies as they are announced and enacted and will make adjustments to our macroeconomic outlook.

That being said, the current economic data for the City of Newport Beach economy is trending in the right direction, as is the national economy overall. At the end of November, the U.S. Bureau of Economic Analysis released its revised estimate for third-quarter gross domestic product growth, which came in at 3.2% over the prior quarter on a seasonally adjusted annualized basis, the fastest rate of growth in two years. This flies in the face of the negative campaign rhetoric and points to a strong national economy on an upward trajectory. As the national economy continues to grow, there is little doubt the City of Newport Beach economy, and future revenues, will continue to grow as well.

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**ABOUT BEACON ECONOMICS**

Beacon Economics, LLC is a leading provider of economic research, forecasting, industry analysis, and data services. By delivering independent, rigorous analysis we give our clients the knowledge they need to make the right strategic decisions about investment, growth, revenue, and policy. Learn more at [www.BeaconEcon.com](http://www.BeaconEcon.com).

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